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In the

Supreme Court of the United States

OCTOBER TERM 1967

WILLIAM J. ROCHELLE, JR., Trustee in Bankruptcy,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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To the Honorable Chief Justice and Associate Justices of The Supreme Court of The United States:

Your Petitioner, WILLIAM J. ROCHELLE, JR., Trustee in Bankruptcy of the Estate of JOHN MILTON ADDISON, Bankrupt, respectfully submits his petition for writ of certiorari, and prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in the above entitled cause on October 20, 1967.

CITATIONS TO OPINIONS BELOW

The Opinion of the Referee in Bankruptcy (R. 16-20) is unreported, and is printed in Appendix D hereto, infra pp. 31-36. The opinion of the District Court (R. 155-166) is unreported, and is printed in Appendix C hereto, infra

pp. 21-29. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, infra, pp. 11-18 is not yet reported.

JURISDICTION

The Judgment of the Court of Appeals was entered on October 20, 1967. (R. Vol. II), Appendix B-1 infra, pp. 19-20. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Whether or not the proceeds of otherwise nontaxable contractual loan transactions are converted into gross income of the borrower if the borrower makes misrepresentations to the lenders in order to induce the lenders to make the loans.

STATUTE INVOLVED

The statutory provisions involved are Sec. 61 of the Internal Revenue Act, 26 U.S.C. 61. The statutory provisions are printed in Appendix A infra, page 9.

STATEMENT

The bankrupt Addison in the course of his operations as a uranium promoter was advanced in excess of $800,000.00 by third parties which he promised to repay. The bankrupt promised to repay such loans out of operation of a uranium upgrader and other business ventures. Immediately prior to bankruptcy the bankrupt was in possession of a bag containing approximately $124,000.00 in checks, money orders and cash. The United States, having made a unilateral

determination that Addison owed taxes in that amount, or more, caused levies to be made on the bag and contents, and filed a claim for taxes pursuant to such determination.

Upon hearing the objections to the claim by the trustee, the facts developed before the Referee showed that all advances made to Addison were in reliance upon his promise to repay the money with interest, that no sums were received without an unconditional obligation to repay, and that all sums were expended in furtherance of Addison's promotions, except the contents of the bag.

The Referee found that in every transaction where the bankrupt obtained money there existed a consensual recognition between Addison and the lenders, express in some instances and implied in the remaining instances, of the obligation of Addison to repay the money to the lenders advancing same.

The Referee further found that the subjective intent of the bankrupt, undisclosed to the lenders, not to repay the same, would not convert into taxable income that which was clearly not income under the Statutes and otherwise not taxable. (R. 16)

Accordingly, the Referee denied the Government's claim that the funds represented income; upon Petition for Review, the District Judge affirmed the Referee's decision.

The Circuit Court reversed, holding:

> "Is money obtained from a swindle taxable income to the swindler? We hold that it is. And it makes no difference if the swindle is in the form of a loan and the 'lenders' so beguiled that they really believe they made bona fide loans."

The holding of the Circuit Court is contrary to the holding of this court in *James v. United States*, 366 U.S. 213, 81 S. Ct. 1052, 6 L. ed. 2d 246. In that case this court recognized the two prerequisites to take the acquisition of earnings out of the category of taxable income, viz., the taxpayer received the money without restrictions as to its disposition, and without a consensual recognition, express or implied, of an obligation to repay it.*

The court said, "When a taxpayer acquires earnings, lawfully or unlawfully"! The absence or presence of a crime in obtaining the money was not even an element for consideration.**

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* In *James* the Government's Brief (p. 11) pointed out:

> "The embezzlement of funds cannot be assimilated to a capital transaction such as a loan because the embezzler in the practical economic sense realizes an 'accession to wealth' which the borrower does not. (p. 13)

** Again in its Brief in *James* the Government clearly points out:

> "Nor can embezzled funds be likened to the proceeds of a loan, the borrower unconditionally manifests and acknowledges his purpose, intention and liability to make repayment. The accession in his assets is accompanied by a corresponding increase in his liabilities, his actual 'wealth' remaining the same. The embezzler, on the other hand, treats the funds as his own, and neither acknowledges nor assents to the *in invitum* duty of repayment. He has a practical matter, the increase in resources, the 'accession to wealth' which no borrower enjoys. On the deduction side, from the lender's point of view, the statute itself recognizes this difference. The lender's taxable income is not reduced by loans made. Only when the loan becomes worthless is a deduction permissible, for until then, the value of the borrower's obligation to repay compensates for the outgo of resources. The victim of embezzlement, by contrast, reduces his income by the amount of the funds taken immediately upon discovery of the theft. His unsatisfied right of recovery from the embezzlement normally has no value ascribed to it." (P. 23)

In *James* the Government Brief further pointed out that James had made restitution of $13,500.00 in 1958, for misappropriations of about three-quarters of a million dollars during the tax period 1951 to 1954.

The court said:

> "When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, 'he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent'. North American Oil Consol. v. Burnet, supra (280 U.S. at p. 424) In such case, the taxpayer has 'actual command over the money the property taxed—the actual benefit for which the tax is paid.' * * * * This standard brings wrongful appropriations within the broad sweep of 'gross income'; it excludes loans." (366 U.S. at p. 219)

The issues presented involve important questions relating to interpretation, administration and enforcement of the Internal Revenue Act and the administration of the Bankruptcy Act. The results of the decision of the Circuit Court are startlingly unconscionable.

FURTHER STATEMENT

The Court of Appeals failed to apply the principles and teachings of *James*. In the instant case it was admitted that the bankrupt Addison had in fact repaid some of the loans made to him, and that all loans which had been made to him had been on the basis of repayment of the same.

The criteria applied by the Circuit Court open a veritable Pandora's Box. Who will lend money unless he can and will be assured that the true purposes and intent of the borrower is to repay it? Failing in such proof, all borrowed money becomes income.

Who will oppose the discharge of a bankrupt on the ground that he has issued a false financial statement? This but paves the way for the Government "to take all".

The criteria of the Circuit Court are based upon criminal convictions in which the intent of the borrower was the element decisive of the question of income, and which concerns itself solely with the intent of the borrower.

It is apparent under the criteria of the Circuit Court no creditor in his right mind would ever assert an objection to the discharge of a bankrupt under the provisions of *Section 14c(3)* of the *Bankruptcy Act*, or seek to preserve his debt under the provisions of *Section 17a(2)* of the Act. To do so would put him into competition with the United States for the very "wealth" or "economic benefits" that he created in the bankrupt by selling his merchandise on credit or lending him money. The Circuit Court has wholly misconceived the teachings of this Court in *James*. It rides roughshod over principles there announced by this court.

The criterion of swindling relied upon by the Circuit Court is a false one. Swindling is committed not by the presence or absence of an intention to repay, or by the making of a false promise to repay, but by the fraudulent misrepresentation of an existing fact.* One can commit the

* The Circuit Court cites its own decision in *Akers v. Scoffield*, 167 F. 2d 718. The proceeds of the swindle were taxable, not because the money was obtained by a swindle, but because there existed no debtor-creditor relationship.

Rutkin v. United States, 343 U.S. 130, 72 S. Ct. 571, was an extortion case, with no part of the opinion applying to a debtor-creditor relationship.

In re Parr, 205 F. Supp. 492 (S.D. Tex.), involved theft of funds from a county and did not involve loans, and in *Cohen* the lower court was careful to exclude loans from consideration by the jury. *Cohen v. U. S.*, 297 F. 2d 760.

offense, even though he does have the intent and purpose to repay. If it be the law that all funds obtained by and through borrowing, are "income" where the borrower has the intent not to repay, then those who enter the Bankruptcy Court must "leave all hope behind."

The decision of the Circuit Court constitutes a radical departure from the heretofore well settled principles of law. If allowed to stand, it would fundamentally and adversely affect the rights of creditors.

CONCLUSIONS

For the foregoing reasons this petition for writ of certicrari should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have delivered to Hon. Melvin Diggs, United States Attorney and to Martha Jo Stroud, Assistant United States Attorney, by depositing one copy thereof in the United States Mail in an envelope bearing sufficient postage, and addressed to them, U. S. Post Office and Courthouse, Fort Worth, Texas, and United States Post Office and Courthouse, Dallas, Texas, respectively.

Wm. Madden Hill

APPENDIX A

Title 26 U.S.C.

Sec. 61. Gross income defined

(a) General definition.—Except as otherwise provided in this subhead gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.